

response to financial sector dislocation and the impact of rising oil prices on real disposable income. Euro appreciation and a weaker export market also diminished growth expectations. The effects were not felt equally across Europe, however, as the smaller European countries, such as Austria, the Netherlands, and Sweden, continued to grow well above potential in the second half of 2007.

Looking forward, the IMF projects growth in the euro area to decelerate to 1.4 percent in 2008 and 1.2 percent in 2009. Export growth will likely hold up through the first half of 2008, based on full order books, especially in Germany, but is projected to fall off in the second half of the year, as a moderation in global demand and euro appreciation slow export growth. The impact of the U.S. slowdown will feed through with a short lag, as fourth-quarter-2008-over-fourth-quarter-2007 growth is expected to fall to 0.9 percent before recovering to an expected fourth-quarter-2009-over-fourth-quarter-2008 1.6 percent rate of growth, a year later.

United Kingdom

Real GDP growth in the U.K. has accelerated over the past three years, rising from 1.8 percent in 2005 to 2.9 percent the next year to 3.1 percent in 2007. However, like the euro area, signs of a slowdown emerged in the fourth quarter as GDP growth slowed to 2.5 percent on an annualized basis.

For 2007, growth was driven by consumer expenditures, which increased 3.1 percent. Gross fixed capital formation remained a strength as it grew by 5.0 percent, although lower than the 7.9 percent pace registered a year earlier. The change in the level of inventories was up by £6.5 billion. A rise in the trade deficit in real terms, to £44 billion from £36 billion a year earlier, acted as a drag on GDP in 2007, resulting in a subtraction of 0.6 percentage points from GDP growth.

The U.K. is feeling the effects of the global market turbulence: the rate of expansion in the British financial services sector has dampened and lending

to companies and households has tightened. British housing prices have now fallen for six consecutive months and the rate of decline is set to accelerate⁵. For the United Kingdom, growth is forecast to slow to 1.6 percent in 2008, as the lagged effects of the 2007 monetary tightening, a turning in the house price cycle, and the financial turbulence are projected to slow activity. Economic activity is forecast to remain below potential through 2009, with projected growth of 1.6 percent for that year, although growth is expected to pick up towards the second half of the year, with an expected fourth-quarter-2009-over-fourth-quarter-2008 rate of growth of 2.3 percent.

Japan

After picking up momentum in 2006, growth in Japan edged down in 2007 mainly on problems encountered during the first half of the year. For the year as a whole, growth eased to 2.1 percent from 2.4 percent in 2006. However, the Japanese economy remained largely resistant to the global slowdown through the end of the year. Fourth quarter GDP grew at an annualized rate of 3.5 percent, led by robust net exports and business investment. Business investment rebounded after contracting during the first half of the year. Exports continued to be supported by strong demand from Asia and Europe. The emerging Asian economies now account for nearly one-half of Japanese exports, while the United States and the euro area have declined to slightly over a third of the total. Following the tightening of building standards in June, the slump in residential investment continued and household spending remained weak.

The growth momentum entering 2008 appears to have slowed with deteriorating business and consumer confidence, and export growth showing signs of moderating. Higher food and fuel prices and sluggish wages continue to weigh on consumption, and business investment could weaken if the global financial market turmoil were to intensify and credit conditions were to tighten further, although the

⁵ United Kingdom Country Report. Economist Intelligence Unit. April 2008